



[6714-01-P]

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 324

RIN 3064 – AD96

Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets;

Market Discipline and Disclosure Requirements; Initial Regulatory Flexibility

Analysis

AGENCY: Federal Deposit Insurance Corporation.

ACTION: Initial regulatory flexibility analysis.

SUMMARY: On August 30, 2012, the Federal Deposit Insurance Corporation (FDIC), together with the Board of Governors of the Federal Reserve System (FRB) and Office of the Comptroller of the Currency (OCC) (together, the agencies) published in the Federal Register a joint notice of proposed rulemaking, titled, “Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements” (Standardized Approach NPR or Proposed Rule). The Proposed Rule would revise and harmonize the agencies’ rules for calculating risk-weighted assets to enhance risk-sensitivity and address weaknesses identified over recent years, including by incorporating certain international capital standards of the Basel Committee on Banking Supervision (BCBS) set forth in the standardized approach of the international accord titled, “International Convergency of Capital Measurement and Capital Standards: A Revised Framework”, as revised by the BCBS in 2006 and 2009, as well as other proposals set forth in consultative papers of the BCBS.

Section 3(a) of the Regulatory Flexibility Act (RFA) directs all federal agencies to publish an initial regulatory flexibility analysis (IRFA), or a summary thereof, describing the impact of a proposed rule on small entities anytime an agency is required to publish a notice of proposed rulemaking in the Federal Register. As provided in the Standardized Approach NPR, the agencies are separately publishing initial regulatory flexibility analyses for the Proposed Rule. Accordingly, the FDIC is seeking comment on the IRFA provided in this Federal Register document, which describes the economic impact of the Standardized Approach NPR, in accordance with the requirements of the RFA. Comments received in connection with this IRFA will be considered for purposes of the development of any final rule to implement the Standardized Approach NPR.

DATES: Comments on this initial regulatory flexibility analysis must be submitted on or before *[Insert date 30 days after date of publication in the Federal Register]*.

ADDRESSES: You may submit comments by any of the following methods:

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow instructions for submitting comments.
- Agency Website: <http://www.fdic.gov/regulations/laws/federal/propose.html>.
- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments/Legal ESS, Federal Deposit Insurance Corporation, 550 17th Street N.W., Washington, DC 20429.
- Hand Delivered/Courier: The guard station at the rear of the 550 17th Street Building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m.
- Instructions: Comments submitted must include “FDIC” and “RIN 3064 – AD96”. Comments received will be posted without change to

<http://www.fdic.gov/regulations/law/federal/propose.html>, including any personal information provided.

FOR FURTHER INFORMATION CONTACT: Bobby R. Bean, Associate Director, bbean@fdic.gov; Ryan Billingsley, Chief, Capital Policy Section, rbillingsley@fdic.gov; Karl Reitz, Chief, Capital Markets Strategies Section, kreitz@fdic.gov, Division of Risk Management Supervision; Capital Markets Branch, Division of Risk Management Supervision, (202) 898-6888; or Mark Handzlik, Counsel, mhandzlik@fdic.gov, Michael Phillips, Counsel, mphillips@fdic.gov Supervision Branch, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429.

SUPPLEMENTARY INFORMATION:

On August 30, 2012, the agencies published in the Federal Register the Standardized Approach NPR to revise the agencies’ general risk-based capital requirements for determining risk-weighted assets (that is, the calculation of the denominator of a banking organization’s risk-based capital ratios).¹ The Proposed Rule would revise and harmonize the agencies’ rules for calculating risk-weighted assets to enhance risk-sensitivity and address weaknesses identified over recent years, including by incorporating certain international capital standards of the Basel Committee on Banking Supervision (BCBS) set forth in the standardized approach of the international accord titled, “International Convergence of Capital Measurement and Capital Standards: A Revised Framework” (Basel II), as revised by the BCBS between 2006 and 2009, as well as other proposals addressed in recent consultative papers of the BCBS.² In the

¹ 77 FR 52888 (Aug. 30, 2012).

² Subsequent to the issuance of Basel II, in December, 2010, the BCBS issued “Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems” (Basel III). The U.S.

Standardized Approach NPR, the agencies also proposed alternatives to credit ratings for calculating risk-weighted assets for certain assets, consistent with section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The revisions include methodologies for determining risk-weighted assets for residential mortgages, securitization exposures, and counterparty credit risk. The changes in the Standardized Approach NPR are proposed to take effect on January 1, 2015, with an option for early adoption. The Standardized Approach NPR also introduces disclosure requirements that would apply to top-tier banking organizations domiciled in the United States with \$50 billion or more in total assets, including disclosures related to regulatory capital instruments.

Section 3(a) of the RFA³ requires an agency to publish in the Federal Register an IRFA or a summary of its IRFA, or to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities. For purposes of the IRFA, a small entity includes a banking organization with total assets of \$175 million or less.

As provided in the Standardized Approach NPR, the agencies are separately publishing their respective IRFA. Accordingly, the FDIC is seeking comment on the IRFA provided in this Federal Register document, which describes the economic impact of the Standardized Approach NPR, in accordance with the requirements of the RFA. Comments received in connection with this IRFA will be considered for purposes of the development of any final rule to implement the Standardized Approach NPR. A summary of the FDIC's IRFA for the Standardized Approach NPR is set forth below.

implementation of Basel III has been proposed by the agencies in a separate notice of proposed rulemaking that is discussed later in this document.

³ 5 U.S.C. 601 et seq.

Summary of the FDIC's IRFA

In accordance with the requirements of the RFA, the FDIC is publishing this summary of the IRFA for the Standardized Approach NPR.⁴ For purposes of this IRFA, the FDIC analyzed the potential economic impact of the Standardized Approach NPR on the small entities that it regulates.

The FDIC welcomes comment on all aspects of the summary of its IRFA. Comments received in response to this IRFA will be considered by the FDIC for purposes of any final rule implementing the Standardized Approach NPR. The FDIC will conduct a final regulatory flexibility analysis after consideration of comments received during the public comment period.

A. Reasons Why the Proposed Rule is Being Considered by the Agencies; Statement of the Objectives of the Proposed Rule; and Legal Basis

As discussed in the Standardized Approach NPR, the agencies are proposing to revise their capital requirements to promote safe and sound banking practices, implement Basel II (as later revised), and harmonize capital requirements across charter type. The NPR also proposes alternatives to the use of credit ratings consistent with section 939A of the Dodd-Frank Act by revising regulatory capital requirements to remove all references to, and requirements of reliance on, credit ratings. Federal law authorizes each of the agencies to prescribe capital standards for the banking organizations it regulates.

B. Small Entities Affected by the Proposal.

Under regulations issued by the Small Business Administration,⁵ a small entity includes a depository institution or bank holding company with total assets of

⁴ 77 FR 52888.

⁵ See 13 CFR 121.201.

\$175 million or less. As of As of March 31, 2012, the FDIC was the primary Federal regulator for approximately 2,433 small state nonmember banks, 115 small savings banks, and 45 small state savings associations (collectively, small banks and savings associations).

C. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The Standardized Approach NPR includes changes to the general risk-based capital requirements that address the calculation of risk-weighted assets and affect small banks and savings associations. The Proposed Rule would affect small banks and savings associations, including:

1. Changing the denominator of the risk-based capital ratios by revising the asset risk weights;
 2. Revising the treatment of counterparty credit risk;
 3. Replacing references to credit ratings with alternative measures of creditworthiness;
 4. Providing more comprehensive recognition of collateral and guarantees;
- and
5. Providing a more favorable capital treatment for transactions cleared through qualifying central counterparties.

These changes are designed to enhance the risk-sensitivity of the calculation of risk-weighted assets. Therefore, capital requirements may go down for some assets and up for others. For those assets with a higher risk weight under the NPR, that increase may be large in some instances, for example, the equivalent of a dollar-for-dollar capital charge for some securitization exposures.

In order to estimate the impact of the Standardized Approach NPR on small banks and savings associations, the FDIC used currently available data from the quarterly Consolidated Report of Condition and Income (Call Reports) filed by small banks and savings associations to approximate the change in capital under the proposed rule. After comparing the existing risk-based capital rules with the proposed rule, the FDIC estimates that risk-weighted assets may increase by 10 percent under the proposed rule. Using this assumption, the FDIC estimates that a total of 76 small banks and savings associations will need to raise additional capital to meet their regulatory minimums. The FDIC estimates that this total projected shortfall will be \$34 million and that the cost of lost tax benefits associated with increasing total capital by \$34 million will be approximately \$0.2 million per year. Averaged across the 76 affected institutions, the cost is approximately \$2,500 per institution per year.

To comply with the requirements of the Proposed Rule, small banks and savings associations would be required to change their internal reporting processes. These changes would require some additional personnel training and expenses related to new systems (or modification of existing systems) for calculating regulatory capital ratios.

Additionally, small banks and savings associations that hold certain exposures would be required to obtain additional information under the proposed rules in order to determine the applicable risk weights. For example, small banks and savings associations that hold exposures to sovereign entities other than the United States, foreign depository institutions, or foreign public sector entities would have to acquire Country Risk Classification ratings produced by the Organization for Economic Co-Operation and Development (OECD) to determine the applicable risk weights. Small banks and savings

associations that hold residential mortgage exposures would be required to have and maintain information about certain underwriting features of the mortgage as well as the loan-to-value (LTV) ratio in order to determine the applicable risk weight. Generally, small banks and savings associations that hold securitization exposures would need to obtain sufficient information about the underlying exposures to satisfy due diligence requirements and apply either the simplified supervisory formula approach (SSFA) or the gross-up approach described in section __.43 of the Proposed Rule to calculate the appropriate risk weight, or be required to assign a 1,250 percent risk weight to the exposure.

Small banks and savings associations typically do not hold significant exposures to foreign entities or securitization exposures, and the agencies expect any additional burden related to calculating risk weights for these exposures, or holding capital against these exposures, would be relatively modest. The FDIC estimates that, for small banks and savings associations, the cost of implementing the alternative measures of creditworthiness will be approximately \$39,000 per institution.

Some small banks and savings associations may hold significant residential mortgage exposures. If a small bank or savings association originates the exposure, it should have sufficient information to determine the applicable risk weight under the proposed rule. However, if the exposure is acquired from another institution, the information needed to determine the applicable risk weight should normally be collected for portfolio monitoring purposes and internal risk management.

Small banks and savings associations would not be subject to the disclosure requirements in the Proposed Rule. However, the agencies expect to modify regulatory

reporting requirements that apply to small banks and savings associations to reflect the changes made to the agencies' capital requirements in the Proposed Rule. The agencies expect to propose these changes to the relevant reporting forms in a separate notice.

To determine if the Proposed Rule has a significant economic impact on small banks and savings associations we compared the estimated annual cost with annual noninterest expense and annual salaries and employee benefits for each institution. If the estimated annual cost was greater than or equal to 2.5 percent of total noninterest expense or 5 percent of annual salaries and employee benefits we classified the impact as significant. The FDIC has concluded that the proposals included in the NPR would exceed this threshold for 2,413 small state nonmember banks, 114 small savings banks, and 45 small state savings institutions. Accordingly, for the purposes of this IRFA, the FDIC has concluded that the changes proposed in the Standardized Approach NPR, when considered without regard to other changes to the capital requirements that the agencies simultaneously are proposing, would have a significant economic impact on a substantial number of small banks and savings associations.

Additionally, it may be informative to consider the changes proposed in the Standardized Approach NPR together with changes proposed in the separate notice of proposed rulemaking published jointly by the agencies in the Federal Register on August 30, 2012, titled, "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action; Proposed Rule"(Basel III NPR).⁶ The changes described in the Basel III NPR include changes to minimum capital requirements that would impact small banks and savings associations. These include a more conservative definition of

⁶ 77 FR 52792

regulatory capital, a new common equity tier 1 capital ratio, a higher minimum tier 1 capital ratio, new thresholds for prompt corrective action purposes, and a new capital conservation buffer.

To estimate the impact of the Basel III NPR on the capital needs of small banks and savings associations, the FDIC estimated the amount of capital such institutions will need to raise to meet the new minimum standards relative to the amount of capital they currently hold. To estimate new capital ratios and requirements, the FDIC used currently available data from the quarterly Call Report) submitted by small banks and savings associations to approximate capital under the Basel III NPR. The Call Reports show that most small banks and savings associations have capital levels well above the existing minimum requirements.

After comparing existing levels with the proposed new requirements under the Basel III NPR, the FDIC determined that 62 small banks and savings associations that it regulates would fall short of the proposed increased capital requirements. Together, those institutions would need to raise approximately \$164 million in regulatory capital to meet the proposed minimum requirements set forth in the Basel III NPR. The FDIC estimates that the cost of lost tax benefits associated with increasing total capital by \$164 million will be approximately \$0.9 million per year. Averaged across such institutions, the cost attributed to the Basel III NPR is approximately \$15,000 per institution per year.

The FDIC concluded for purposes of its IRFA for the Basel III NPR⁷ that the changes described in the Basel III NPR, when considered without regard to changes in this NPR, would not result in a significant economic impact on a substantial number of

⁷ Id. at 52836.

small banks and savings associations, given the nominal compliance requirements that likely would result from the future adoption by the agencies of the Basel III NPR

As noted above, the FDIC has concluded that the proposed changes in the Standardized Approach NPR would result in a significant economic impact on a substantial number of small banks and savings associations. Further, if both the Standardized Approach NPR and the Basel III NPR were adopted, there would be a significant economic impact on a substantial number of small banks and savings associations.

D. Identification of Duplicative, Overlapping, or Conflicting Federal Rules

The FDIC is unaware of any duplicative, overlapping, or conflicting federal rules. As noted previously, the FDIC anticipates issuing a separate proposal to implement reporting requirements that are tied to (but do not overlap or duplicate) the requirements of the proposed rules. The FDIC seeks comments and information regarding any such federal rules that are duplicative, overlapping, or otherwise in conflict with the Proposed Rule.

E. Discussion of Significant Alternatives to the Proposed Rule

The agencies have sought to incorporate flexibility into the Proposed Rule and lessen burden and complexity for small banks and savings associations wherever possible, consistent with safety and soundness and applicable law, including the Dodd-Frank Act. The agencies are requesting comment on potential options for simplifying the Proposed Rule and reducing burden, including whether to permit certain small banks and savings associations to continue using portions of the current general risk-based capital

rules to calculate risk-weighted assets. Additionally, the agencies proposed the following alternatives and flexibility features:

- Small banks and savings associations are not subject to the enhanced disclosure requirements of the Proposed Rule.
- Small banks and savings associations would continue to apply a 100 percent risk weight to corporate exposures (as described in section __.32 of the Proposed Rule).
- Small banks and savings associations may choose to apply the simpler gross-up method for securitization exposures rather than the SSFA (as described in section __.43 of the Proposed Rule).
- The proposed rule offers small banks and savings associations a choice between a simpler and more complex methods of risk weighting equity exposures to investment funds (as described in section __.53 of the Proposed Rule).

The FDIC welcomes comment on any significant alternatives to the Standardized Approach NPR applicable to small banks and savings associations that would minimize their impact on those entities.

Dated at Washington, DC, this 12th day of October, 2012.

Federal Deposit Insurance Corporation.

Robert E. Feldman.
Executive Secretary.

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